

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT OF EXAMINATION OF

CENTENNIAL CASUALTY COMPANY

BIRMINGHAM, ALABAMA

AS OF DECEMBER 31, 2005

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STATE OF ALABAMA
COUNTY OF JEFFERSON

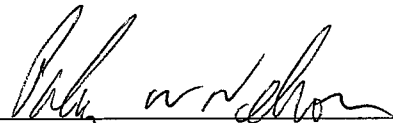
I, Palmer W. Nelson, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;


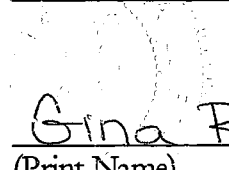
That an examination was made of the affairs and financial condition of Centennial Casualty Company for the period of January 1, 2001 through December 31, 2005;

That the following 32 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And that the statements, exhibits and data therein contained are true and correct to the best of his knowledge and belief.


Palmer W. Nelson, CFE

Subscribed and sworn to before the undersigned authority this 26th day of April, 2007.



Gina Robinson, Notary Public
(Print Name)

in and for the State of Alabama.

My commission expires 10-6-08.



BOB RILEY
GOVERNOR

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WALTER A. BELL
COMMISSIONER

DEPUTY COMMISSIONER
D. DAVID PARSONS

CHIEF EXAMINER
RICHARD L. FORD

STATE FIRE MARSHAL
EDWARD S. PAULK

GENERAL COUNSEL
REYN NORMAN

RECEIVER
DENISE B. AZAR

LICENSING MANAGER
JIMMY W. GUNN

Birmingham, Alabama
April 26, 2007

Honorable Walter A. Bell
Commissioner of Insurance
Alabama Department of Insurance
Post Office Box 303351
Montgomery, Alabama 36130

Dear Commissioner:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

Centennial Casualty Company
Birmingham, Alabama

as of December 31, 2005, at its home office located at 2200 Woodcrest Place, Suite 200, Birmingham, Alabama 35209. The report of examination appears herewith.

Where the term "Company" appears herein without qualification, it will be understood to indicate Centennial Casualty Company.

SCOPE OF EXAMINATION

A full scope examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the five year period ended December 31, 2000. The current examination covers the intervening period from January 1, 2001 through December 31, 2005, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2005, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2005, as shown in the financial statements contained herein. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the Alabama Insurance Code, the Insurance Department's rules and regulations, or statutory accounting principles which were deemed to require comments and/or recommendations.

A signed certificate of representation was obtained during the course of the examination. In the certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2005. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through the date of this report, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities. An office copy of the Company's filed Annual Statement as of December 31, 2005, was compared with or reconciled to account balances with respect to ledger items.

The Company's accounts were examined by Ernst & Young, LLP, certified public accountants (CPAs), for the first three years of the examination period. The Company's accounts were examined by Warren, Averett, Kimbrough & Marino, LLC, CPAs, for the final two years of the examination period. The examiners utilized some of the CPAs work papers in conjunction with the examiners' test work to complete some of the audit procedures in instances in which the examiners determined that it was appropriate.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, advertising and marketing, claims, policyholder complaints, agents' licensing practices, and compliance with privacy standards.

ORGANIZATION AND HISTORY

The Company was incorporated on September 25, 1975, as a stock insurance corporation, and commenced business on that same day.

The original Articles of Incorporation authorized 30,000 shares of \$10 par value common stock. The Company began with \$300,000 of capital and \$450,000 of paid in surplus contributed by the Company's parent, Auction Insurance Agency, in exchange for a surplus note, in the same amount, issued by the Company. The surplus note has since been paid off and Auction Insurance Agency has merged with Robinson-Adams Agency, Inc., and the name of the surviving corporation was changed to Robinson-Adams Insurance, Inc. The Company's authorized capital stock was increased on January 4, 1982, to 50,000 shares of common stock. As of the examination date, the Company reported a capital structure of capital stock of \$500,000, gross paid in and contributed surplus of \$797,090, and unassigned funds of \$41,834,997.

MANAGEMENT AND CONTROL

Stockholders

The common stock of the Company was 100% owned by Robinson-Adams Insurance, Inc., an Alabama corporation, at December 31, 2005.

The examination indicated that the stockholder did not comply with the Company's By-Laws by conducting its annual meeting on the first Thursday in March of each year for each year under examination. The 2001 stockholder meeting was held on Thursday, December 20, 2001. The 2003 meeting was held on Friday, March 7, 2003.

Board of Directors

The Company's By-Laws stipulate that its business shall be managed and controlled by a Board of Directors who shall be elected by the stockholders. The number of directors shall not be less than three or more than seven directors.

The following directors were elected by the stockholder and were serving at December 31, 2005.

<u>Director and Place of Residence</u>	<u>Principal Occupation and Employer</u>
Thomas Jefferson Adams, Jr. Birmingham, Alabama	Insurance Management Robinson-Adams Insurance, Inc.
Richard Manly Adams Mountain Brook, Alabama	Insurance Sales Robinson-Adams Insurance, Inc.
Robin McKinney Price Hoover, Alabama	Accountant Robinson-Adams Insurance, Inc.

Committees

The Company had no board committees during the period covered by the examination.

Officers

The Company's By-Laws provide that its executive officers shall be a President, one or more Vice Presidents, a Secretary, and a Treasurer, each of whom shall be elected by the Board annually and shall hold office until their successors are elected and qualified. Other officers may be appointed as deemed necessary by the Board of Directors. Officers elected at the March 3, 2005 annual meeting of the Board of Directors, and serving at December 31, 2005, were as follows.

<u>Name</u>	<u>Title</u>
Thomas Jefferson Adams, Jr.	President
Richard Manly Adams	Vice President
Tommy Steven DeMedicis	Vice President
William Seldon Dodson, Jr.	Vice President
Brandon Matthew Walton	Vice President
Robin McKinney Price	Secretary/Treasurer
Jane Witherspoon	Assistant Secretary/Treasurer

Management and Service Agreements

The Company had no employees during the examination period. At December 31, 2005, the Company had five management and service or agency agreements with its affiliates to provide for the operations of the Company. All agreements were approved by the Alabama Department of Insurance.

Agency Agreement with Robinson-Adams Agency, Inc. Effective November 15, 1992, Amended January 1, 1994

The provisions of the agreement were as follows: (1) The Company appointed Robinson-Adams Agency, Inc. (RAA) and certain of its licensed employees as agents for the writing and issuance of policies of insurance; (2) The Company has the authority to accept or reject certain risks and the rate or premium at which any policy of insurance was issued; and (3) RAA agreed to be responsible for premium collection and the remittance to the Company for surety bonds and other insurance. The agreement was amended effective January 1, 1994, to eliminate any compensation paid by the Company to RAA on insurance placed by RAA with the Company.

Management, Operating and Service Agreement with Robinson-Adams Insurance, Inc. Effective April 1, 2000

The agreement noted that the Company had no employees to manage its affairs and Robinson-Adams Insurance, Inc. (RAI) had facilities and staff for servicing policies. The following terms were agreed to: (1) RAI agreed to provide services and function as the Company's underwriting department and have the authority to determine which risks are acceptable and the rate or premium at which any policy of insurance is issued; however, RAI shall accept risks only from agents acceptable to and duly appointed by the Company; (2) RAI agreed to provide all secretarial, accounting, clerical and data processing services needed for the efficient operation of the Company. RAI also agreed to supply all office equipment,

telephone services including long distance service, and office facilities necessary for the operation of the Company; (3) RAI had the authority and responsibility to manage the Company's investment portfolio; however, investment decisions had to be approved by a Company officer; and (4) Compensation for the stipulated services was \$150,000 annually paid monthly.

Loss Adjustment Service Agreement with Woodcrest Services, Inc. Effective November 15, 1992

The provisions of the agreement were as follows: (1) The Company appointed Woodcrest Services, Inc. (WS) as its exclusive loss adjusting agent; (2) WS was to perform the following functions: (a) Coordinate and make all claim payments (b) Supervise the continuing activities of the Company's law firm of Norman, Fitzpatrick & Wood (c) Supervise and monitor outside attorneys (d) Supervise all repossession activities (e) Act in the capacity as General Counsel; (3) Compensation for the stipulated services was seven per cent of all premiums on check and title policies; and (4) WS's operation will be at its own expense.

Service Agreement with Woodcrest Services, Inc. Effective April 1, 1994, Amended January 1, 1997

The provisions of the agreement were as follows: (1) In addition to the loss payment services that Woodcrest Services, Inc. (WS) already provided for the Company under another agreement, the Company also employed WS as its sales agent for check and title insurance policies; (2) WS was required to provide all necessary sales representatives, secretarial, accounting, clerical, data processing and telephone services necessary for the efficient production of check and title insurance premium; (3) WS was not given any underwriting authority, but the licensed agents of WS were appointed for the writing of check and title policies; (4) WS was required to give a detailed account to the Company on any material transaction, including information necessary to support all commissions, charges and other fees received by or owed to WS; (5) All funds due under the terms of the agreement were to be sent to the Company on at least a monthly basis. Premiums or any installment collected by WS were to be remitted no later than 90 days after the effective date of any policy; (6) Reinsurance may be negotiated, but not bound by WS on behalf of the Company; and, (7) Compensation for WS services was as follows: (a) Ten per cent of all premiums on check and title policies (b) A contingent commission equal to the earned premium less 45% for the Company's expenses, less losses times 25%. However, said calculation shall not be made and no payment issued until one year after premiums are earned and until the adequacy of the Company's reserves on remaining claims has been independently verified as outlined in Chapter 6B of the Alabama Insurance Code. The first calculation shall be made on premium written from the inception of this agreement through December 31, 1994, however, no payment shall be made until April 1, 1996. Settlements under the contingent commission provision shall be made each April 1 thereafter with any deficit carried forward to subsequent calculations. Effective January 1, 1997, the regular commission paid under the agreement was increased from ten per cent to twenty per cent.

Service Agreement with Woodcrest Services, Inc. Effective April 1, 2000

As a result of Woodcrest Services, Inc. (WS)'s ownership of Auto Tec, LLC and AutoCheck, LLC, WS had access to a substantial database of 1.2 billion automobile title records and 60,000 automobile dealership records including photographs and related information which could be used effectively to prevent losses and recover losses previously sustained by the Company, the Company entered into a service agreement whereby WS was appointed the Company's loss prevention and loss recovery agent. The provisions of the agreement were as follows: (1) The Company appointed WS as its agent for loss prevention, salvage and subrogation. WS was to take all steps to prevent losses and to salvage and minimize losses; (2) WS agreed to give notice to the insureds of the names of the dealers with whom transactions are unacceptable to the Company for coverage under the policies issued, adding and deleting names of dealers whose transactions with the insureds are unacceptable to the Company for coverage as may from time to time be deemed by WS in the best interest of the operation of this program of insurance. WS shall see to it that all insureds are properly advised of any additions or deletions from the names of automobile dealers with whom insured's transactions will not be covered under the policies issued; and, (3) Compensation for the stipulated services was \$350,000 annually (1/12th to be paid at the end of each month) plus thirty per cent of all recoveries made by WS on losses reported to the Company by its insureds.

Conflicts of Interest

The Company's Board of Directors adopted a statement of Company policy relative to conflicts of interest on March 25, 1994. The policy states "Centennial Casualty Company ('Centennial') nor any of its officers, directors or stockholders ('Principals') will own an equity interest in, have a financial interest in, or serve as an officer or director of any agency or brokerage company through whom it writes insurance without disclosing such interest or position to Centennial Casualty Company's Board of Directors and to the Alabama Department of Insurance." Each officer and director that served during the examination period signed a conflict of interest disclosure statement. There were not any conflicts disclosed.

CORPORATE RECORDS

The Company's Articles of Incorporation and By-Laws were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practices and applicable statutes and regulations.

Minutes of the Stockholder and Board of Directors meetings that took place during the examination period were reviewed. The minutes appeared to be complete and to adequately document the actions of the respective governing bodies.

The Company has not performed criminal background checks or required its producers, agency, or subcontractors to attest to the fact that they have not been convicted of a felony involving dishonesty or a breach of trust. Section 1033 of Title 18 of the United States Code prohibits a person who has been convicted of a felony involving dishonesty or a breach of trust from willfully engaging in the business of insurance that affects interstate commerce

unless the prohibited person has obtained permission from the Commissioner. ALA. ADMIN. CODE 121 elaborates on the definition of a prohibited person under Section 1033 of Title 18 of the United States Code. Prohibited persons may be employees, producers, insurance agencies, consultants, third party administrators, or managing general agents of the Company or subcontractors of the Company or of an agency of the Company who have been convicted of a felony involving dishonesty or a breach of trust unless the prohibited person has obtained permission to serve in the capacity by the Commissioner.

HOLDING COMPANY AND AFFILIATE MATTERS

The Company is subject to the Alabama Insurance Company Regulatory Act of 1973 as defined in ALA CODE §27-29-1(1975). The review of the holding company filings made during the examination period indicated that appropriate disclosures were made regarding the Company.

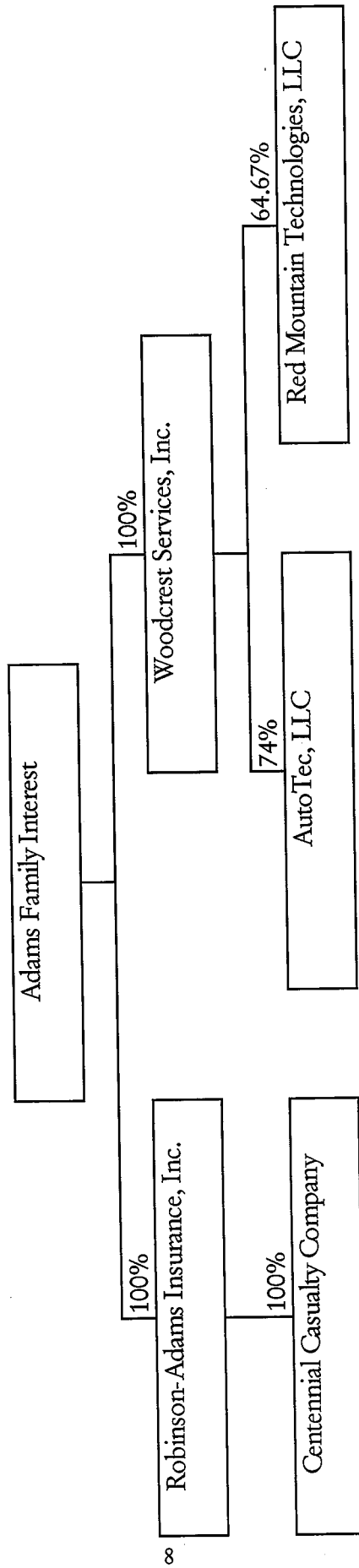
Dividends to Stockholders

There were no stockholder dividends paid by the Company during the examination period.

Organizational Chart

The organizational chart on the following page depicts the insurance holding company system with which the Company was affiliated as of December 31, 2005.

CENTENNIAL CASUALTY COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2005



FIDELITY BONDS AND OTHER INSURANCE

At December 31, 2005, the Company was a named insured under a policy providing employee crime and dishonesty and forgery and alteration coverage issued by Continental Casualty Company. The maximum policy limit per occurrence exceeded the NAIC suggested minimum amount of coverage.

In addition to the above coverage, the Company was insured by the following types of coverage:

- Commercial General Liability
- Commercial Property
- Commercial Automobile

EMPLOYEE AND AGENT WELFARE

The Company had no employees of its own during the examination period. Its operations were conducted by personnel employed by affiliated companies under management and service agreements. The Company's business is marketed by affiliates Robinson-Adams Insurance, Inc. and Woodcrest Services, Inc. under the provisions of agency agreements. At the examination date, there were five agents appointed to write business for the Company. The employees and agents were compensated by the affiliates. The Company does not provide any benefits for the affiliates' employees or agents. Further discussion of the management and service and agency agreements are included in this report under the caption "Management and Service Agreements."

STATUTORY DEPOSITS

At December 31, 2005, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows.

<u>State</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Alabama	\$200,000	\$200,099	\$200,704
Oklahoma	\$100,000	\$100,000	\$100,000

FINANCIAL CONDITION/GROWTH OF THE COMPANY

	<u>2005*</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Admitted Assets	\$56,918,836	\$55,456,800	\$48,426,058	\$40,181,074	\$41,239,627
Liabilities	14,066,749	16,533,621	14,382,887	12,493,858	12,716,604
Common Capital Stock	500,000	500,000	500,000	500,000	500,000
Paid in and Contributed Surplus	797,090	797,090	797,090	797,090	797,090
Unassigned Funds	41,554,997	37,626,089	32,746,081	26,390,126	27,225,933
Gross Written Premium	8,378,634	11,478,104	10,434,307	9,978,034	6,302,660

*Per Examination

MARKET CONDUCT ACTIVITIES

Plan of Operation

The Company's principal line of business is check and title insurance, which insures wholesale automobile auctions against bad checks and title losses. The Company also writes a small amount of surety bond coverage.

Territory

The Company was licensed to transact business in the State of Alabama only, during the period covered by this examination. In addition to writing business in Alabama, the Company wrote business on a surplus lines basis in the following states in 2005: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. Additionally, in 2005, the Company reported direct written premiums of \$173,198 in Canada and \$27,171 in other foreign jurisdictions.

Policy Forms and Underwriting

Policy Forms and Rate Filings

The examination indicated that all forms and premium rates utilized in Alabama during the examination period that were required to be filed had been properly filed with the Alabama Department of Insurance. Company management indicated that they had received permission to not be required to file its rates for its check and title business. A letter from the Company President, dated February 8, 2006, to the Alabama Department of Insurance Rate Supervisor indicating the previously agreed upon terms for the Company to not be required to submit rate filings for its check and title business was provided to the examiners. For the business in which rate filings were required, the Company used the rates filed with the Department for all Alabama business.

Underwriting Practices

The examination of the Company's underwriting practices included a review of the Company's underwriting guidelines, declination and cancellation procedures as described by Company management. The Company did not provide its employees an underwriting manual or written guidance to follow.

The Company President described the Company's underwriting guidelines as follows.

- (1) Check and Title Insurance - Whenever an auction company applies for coverage, depending on the situation and what the Company knows about the application already, personnel may run a retail credit report on the principals

of the applicant, check references given by the applicant, and/or check with auctions in the general area in which the applicant is doing business or proposing to do business. A check is made to determine whether the dealer is listed in the Company's unapproved dealers listing known internally as the "KO Book." The listing consists primarily of unapproved dealers that the Company has had some check and title loss experience with in which the Company has not collected full loss recoveries in connection with the paid losses. Applicants included in the listing are denied coverage. All underwriting decisions and rate quotations are approved by the Company President.

- (2) Alabama Motor Vehicle Dealer Bonds and Dismantler Bonds – Company personnel check to make sure the applicant is not included in the Company's listing of unapproved dealers. Approval from the applicant to run a retail credit report is obtained. The Company will write bonds only for the dealers with a credit score of 650 or better.
- (3) Notary Bonds – Because of the small policy benefit limits, and because the business comes primarily from either a local law firm or from one bank, the notary bonds are written with no underwriting scrutiny.

The Company was asked to provide applications that were rejected or declined during the examination period. The Company was only able to provide fourteen of their Alabama dealer bond application files. Eight files were for the period from August, 2002 through June, 2004, and six files were provided for 2006. Due to personnel changes, the Company was not certain that all of the requested files had been provided.

The Company could not provide all of the cancelled/non-renewed surety bond files that were requested. The examiner reviewed all of the files provided. A review of 72 files was performed. Thirty-one of the files were documented with the reason for the cancellation/non-renewal and 41 of the files were not documented appropriately. They were stamped cancelled, but the reason for cancellation was not documented. After a meeting with Company personnel, it was determined that the files stamped "Cancelled" were actually non-renewed files.

A sample of fifty cancellations for Check and Title Insurance was selected from a total of 121 cancellations. The examination indicated that 46 of the cancellations were valid according to policy provisions. However, four of the policy files had been lost or misplaced and could not be provided to the examiners.

ALA. CODE §27-27-29(a)(1975) states, in part, "Every domestic insurer... shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Advertising and Marketing

The Company does not have an advertising file or a projected marketing plan. The only advertising done by the Company is in the form of brochures and internet advertising. The

Company maintains control over the content, form and method of advertising by requiring that all advertising be approved by the Company President.

The Company's business was written by Robinson-Adams Insurance, Inc. and Woodcrest Services, Inc. via agency or management and service agreements. Further discussion of the agency and management and service agreements is included in this report under the caption "Management and Service Agreements."

Claims Review

A total of 1,566 claims were paid during 2005. A sample of fifty claim payments was selected and reviewed. The review indicated that 48 of the files reviewed were documented properly and the claim payment was made promptly and in accordance with the policy provisions. The Company was unable to produce one of the files and one of the claim files did not document the date of claim payment. Also, the claim numbers in the claim file did not reconcile to the claim number identified in the losses data for three of the claims.

ALA. ADMIN. CODE 482-1-125.04 states

Each insurer's claim files for policies are subject to examination by the Commissioner of Insurance or by the Commissioner's duly appointed designees. To aid in such examination: (a) The insurer shall maintain claim files that are accessible and retrievable for examination. An insurer shall be able to provide the claim number, line of coverage, date of loss, and date and amount of payment. They shall also be able to provide the same information (except date and amount of payment) for all claims closed without payment. This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim. (b) Each relevant document within the claim file shall reflect as to date received, date processed or date mailed.

Policyholder Complaints

The Company did not receive any complaints during the examination period. The records of the Alabama Department of Insurance reflected one complaint filed against the Company during the examination period. However, after review of the complaint it was determined that the complaint was not against Company but against the Company's insured.

Compliance with Agents' Licensing Requirements

The Company's surety bond business is marketed by an agency that is an affiliate of the Company, Robinson-Adams Insurance, Inc. The Company's check and title business is marketed by an agency that is an affiliate of the Company as well, Woodcrest Services, Inc. Both of the agencies were properly licensed by the Alabama Department of Insurance. Commissions were paid to Woodcrest Services, Inc. only.

As of the examination date the Company had five licensed and appointed agents.

Privacy Standards

The examination indicated that the Company did not handle any private information of applicants or insureds during the examination period.

REINSURANCE

The reinsurance agreements were examined and found to include the proper safeguards and the required clauses such as insolvency clause, entirety clause, errors and omissions clause, and termination clause, as well as define the particular terms of premiums, loss, and commission payments and the rights and responsibilities of both parties.

Reinsurance Ceded

The Company had an excess of loss reinsurance agreement with General Reinsurance Corporation in effect at December 31, 2005. The terms of the agreement were as follows:

Business Covered

New and renewal check and title insurance and floor plan financing insurance;

Term

Effective January 1, 1996, and continuous until terminated by either party;

Territory

Automobile auctions located within the United States of America, its territories or possessions, Puerto Rico, the District of Columbia, and Canada;

Retention and Limits

The reinsurer was liable for any ultimate net loss exceeding \$100,000, but not exceeding \$900,000, for any one occurrence. The aggregate limit of liability for the reinsurer with respect to all occurrences insured during any calendar year shall not exceed \$3,600,000.

Reinsurance Assumed

The Company had an aggregate excess of loss reinsurance agreement with Marketplace Insurance, Inc. in effect at December 31, 2005. The agreement was not executed within nine months following the effective date of the agreement. Further discussion of the failure to execute the agreement is included in this report under the caption "NOTES TO FINANCIAL STATEMENTS." The terms of the agreement were as follows:

Business Covered

Each eligible vehicle sold during the term of the contract and each renewal term sold within the territorial limits provided in the underlying policy;

Term

Effective March 1, 2005, for the calendar year until the next March 1, and the agreement is to automatically renew for each successive twelve month period thereafter until either party provides the required notice of termination specified in the contract;

Territory

The agreement covers losses occurring within the territorial limits provided in the underlying policy;

Retention and Limits

The Company assumes from the cedant the portion of the cedant's ultimate net loss that exceeds the product of \$6.82 times each eligible vehicle sold and is equal to or less than the product of \$8.75 times each eligible vehicle sold during each policy period.

ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained manually, with certain supporting records maintained on electronic data processing equipment. Management and record keeping functions were performed by personnel and facilities of Robinson-Adams Insurance, Inc. and Woodcrest Services, Inc. under the provisions of management and services agreements the entities had entered into with the Company. Further discussion of the aforesaid agreements is included in this report under the caption "Management and Service Agreements."

The Company was audited annually by the independent certified public accounting (CPA) firm of Ernst & Young, LLP, Birmingham, Alabama for the years from 2001 through 2003. The Company was audited for 2004 and 2005 by Warren, Averett, Kimbrough & Marino, LLC, Birmingham, Alabama.

During the examination period, Gary T. Ciardiello, FCAS, MAAA of Ernst & Young, LLP, Atlanta, Georgia prepared the Actuarial Reports and Statement of Opinion for years 2001 through 2003. Paul M. Merlino, FCAS, MAAA of Merlinos & Associates, Inc., Norcross, Georgia prepared the Actuarial Reports and Statement of Opinion for 2004 and 2005.

The Company has obtained two permitted practice letters from the Alabama Department of Insurance allowing the Company to recognize its earned premiums for check and title business in a manner that deviates from statutory accounting principles. The first letter, dated September 10, 1992, granted permission to the Company to earn one half of its premiums for check and title business over a five month period and earn the remaining half over a four year period. A subsequent letter, dated January 17, 2002, granted permission to the Company to earn half of its premiums over a one month period and earn the remaining half of the premiums over a six month period for one specific significant check and title insured. The September 10, 1992 letter stated "If the vehicle sold through the auction is later discovered to be stolen or mortgaged, losses on these auctioned vehicles do not occur until the authorities identify and seize stolen cars during the four-year coverage period as provided in the policy." Also, the letter stated "The booking of your loss reserves should be consistent with the previous earnings assumptions." The Company does not record incurred but not reported loss reserves with respect to its check and title core business.

Information Technology Control Weaknesses

During a meeting with the IT manager it was determined the Company did not have a policy for records retention. Additionally, the IT Manager stated he was unaware of the records retention requirements of IRS Revenue Procedure 1998-25.

During an examination of the Company's business contingency planning it was determined the Company did not have a business contingency plan. Without a business contingency plan, management may be unable to recover from adverse events such as natural disasters.

An affiliate, Red Mountain Technologies, LLC (RMT) performs information systems services for the Company. The examiners requested an agreement between the Company and RMT to examine the agreement and determine how often RMT was required to prepare and store back ups of the Company's data. There was no agreement between the Company and RMT. RMT contracted with a nonaffiliated company, Iron Mountain, to store the back ups. An agreement between RMT and Iron Mountain could not be located. An effective agreement will ensure that RMT retains the required information ensuring that the Company complies with ALA. CODE §27-27-29(a)(1975), which requires the Company to maintain "... complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary and suitable as to the kind, or kinds, of insurance transacted."

Omission of an Actuarial Review by the Independent Auditors

The CPA relied upon the Company's actuary's work and the independent audit did not include a review or test work performed by a qualified actuary.

The CPAs were asked how did the CPAs opine on the Company's financial statements if they did not perform any independent audit work regarding the Company's use of an appropriate reserving methodology? The engagement partner responded to indicate that the CPAs performed the required independent audit work as outlined by SAS No. 73 that allows an auditor to rely upon the work of a specialist, and the evaluation and decision to do so was documented in the work papers. SAS No. 73 says that, if the auditor determines that a specialist's findings support the related assertions in the financials, the auditor may reasonably conclude that sufficient competent evidential matter has been obtained. The CPAs determined that the Company's actuary's findings supported the related assertions in Centennial's financial statements.

The specialist is the Company's consulting and opining actuary. As for utilizing the work of a specialist that has a relationship with the client, AICPA Professional Standards stipulates in Sections 336.10 and 336.11,

The auditor should evaluate the relationship of the specialist to the client, including circumstances that might impair the specialist's objectivity. Such circumstances include situations in which the client has the ability---through employment, ownership, contractual right, family relationship, or otherwise---to directly or indirectly control or significantly influence the specialist. When a specialist does not have a relationship with the client, the specialist's work usually will provide the

auditor with greater assurance of reliability. However, the work of a specialist who has a relationship with the client may be acceptable under certain circumstances. If the specialist has a relationship with the client, the auditor should assess the risk that the specialist's objectivity might be impaired. If the auditor believes the relationship might impair the specialist's objectivity, the auditor should perform additional procedures with respect to some or all of the specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or should engage another specialist for that purpose.

The CPA's and the examiners evaluated the appropriateness of relying upon the Company's actuary's assumptions, methods and findings differently. The CPA's documented an evaluation that did not involve a review by a qualified actuary or any re-testing of the work performed. The examiners' evaluation was that the reliance must include a review by a qualified actuary. In the examiners' view, the involvement of a qualified actuary is consistent with AICPA Professional Standards Sections 336.10 and 336.11. The examiners noted that the Company's consulting and opining actuary has been preparing an original work product that has not been subjected to review and/or testing by an independent, qualified third party with the exception of the periodic Alabama Department of Insurance statutory examinations.

Financial Reporting for Years Prior to 2005

The Company reported a net deferred tax asset and a net deferred tax liability in its 2003 Annual Statement. The accounts are to be netted and reported in one account. SSAP No. 10, paragraph 7 states, in part, "DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position."

FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year of 2005. Amounts shown in the comparative statements for the years 2001, 2002, 2003, and 2004 were compiled from the Company's copies of filed Annual Statements. The statements were presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds	Page 18
Summary of Operations	Page 19
Capital and Surplus Account	Page 20

Centennial Casualty Company
Statement of Assets, Liabilities, Surplus and Other Funds
for the Year Ended December 31, 2005

Assets

	Assets	Non-Admitted Assets	Admitted Assets
Bonds (Note 1)	\$ 6,770,545	\$280,000	\$ 6,490,545
Common stocks	37,350,138		37,350,138
Real estate: Properties occupied by the company	1,769,833		1,769,833
Real estate: Properties held for the production of income (Note 2)	79,263		79,263
Cash (Note 3)	10,358,293		10,358,293
Investment income due and accrued	127,743		127,743
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection	389,168		389,168
Current federal and foreign income tax recoverable and interest Thereon	353,853		353,853
Intangible assets	<u>15,823</u>	<u>15,823</u>	<u>0</u>
TOTALS	<u>\$57,214,659</u>	<u>\$295,823</u>	<u>\$56,918,836</u>

Liabilities, Surplus and Other Funds

Losses (Note 4)	\$ 714,900
Loss adjustment expenses (Note 4)	107,235
Other expenses	46,123
Taxes, licenses and fees	32,247
Net deferred tax liability	5,979,823
Unearned premiums (Note 5)	6,281,201
Ceded reinsurance premiums payable	73,486
Amounts withheld or retained by company for account of others (Note 6)	0
Payable to parent, subsidiaries and affiliates (Note 7)	728,175
Collateral deposits (write-in) (Note 6)	<u>103,159</u>
Total Liabilities	<u>\$14,066,749</u>
Capital and Surplus:	
Common capital stock	\$500,000
Gross paid in and contributed surplus	797,090
Unassigned funds (Note 9)	<u>41,554,997</u>
Total Capital and Surplus	<u>\$42,852,087</u>
Total Liabilities and Stockholders' Equity	<u>\$56,918,836</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Centennial Casualty Company
Summary of Operations
for the Years Ended December 31, 2001, 2002, 2003, 2004, and 2005

	2005	2004	2003	2002	2001
Underwriting Income					
Premiums earned (Note 8)	\$8,770,197	\$11,024,331	\$9,970,322	\$8,685,423	\$5,678,518
Losses incurred	2,760,543	5,520,864	4,269,465	3,852,332	3,364,596
Loss expenses incurred	210,510	742,550	521,959	586,859	367,098
Other underwriting expenses incurred	<u>2,675,446</u>	<u>3,364,755</u>	<u>2,741,752</u>	<u>2,759,314</u>	<u>2,061,863</u>
Total underwriting deductions	<u>\$5,646,499</u>	<u>\$9,628,169</u>	<u>\$7,533,176</u>	<u>\$7,198,505</u>	<u>\$5,793,557</u>
Net underwriting gain (loss)	<u>\$3,123,698</u>	<u>\$1,396,162</u>	<u>\$2,437,146</u>	<u>\$1,486,918</u>	<u>\$(115,039)</u>
Investment Income					
Net investment income earned	\$1,733,685	\$1,453,317	\$1,219,354	\$1,180,032	\$1,319,278
Net realized capital gains/(loss)	<u>446,751</u>	<u>328,620</u>	<u>103,236</u>	<u>96,444</u>	<u>280,656</u>
Net investment gain/(loss)	<u>\$2,180,436</u>	<u>\$1,781,937</u>	<u>\$1,322,590</u>	<u>\$1,276,476</u>	<u>\$1,599,934</u>
Net income before federal and foreign income taxes	\$5,304,134	\$3,178,099	\$3,759,736	\$2,763,394	\$1,484,895
Federal and foreign income taxes incurred	<u>1,395,029</u>	<u>867,806</u>	<u>1,123,310</u>	<u>780,590</u>	<u>322,999</u>
Net income	<u>\$3,909,105</u>	<u>\$2,310,293</u>	<u>\$2,636,426</u>	<u>\$1,982,804</u>	<u>\$1,161,896</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Centennial Casualty Company
Capital and Surplus
for the Years Ended December 31, 2001, 2002, 2003, 2004, and 2005

	2005	2004	2003	2002	2001
Capital and surplus, December 31, prior year	<u>\$38,923,179</u>	<u>\$34,043,171</u>	<u>\$27,687,216</u>	<u>\$28,523,023</u>	<u>\$32,612,009</u>
Net income	\$ 3,909,105	\$ 2,310,293	\$ 2,636,426	\$ 1,982,804	\$ 1,161,896
Change in net unrealized capital gains or (losses)	372,503	3,869,585	5,632,994	(4,295,018)	(1,568,375)
Change in net deferred income tax	(77,742)	(1,310,395)	(1,924,513)	1,512,691	(3,987,968)
Change in nonadmitted assets	(274,958)	10,525	11,048	(36,284)	10,225
Adjustment for over-estimated 2000 Federal income tax expense (write-in)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>295,236</u>
Change in surplus as regards policyholders for the year	<u>\$ 3,928,908</u>	<u>\$ 4,880,008</u>	<u>\$ 6,355,955</u>	<u>\$ (835,807)</u>	<u>\$(4,088,986)</u>
Surplus as regards policyholders December 31, current year	<u>\$42,852,087</u>	<u>\$38,923,179</u>	<u>\$34,043,171</u>	<u>\$27,687,216</u>	<u>\$28,523,023</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Bonds

\$6,490,545

The above captioned amount is \$280,000 less than the \$6,770,545 reported by the Company in its 2005 Annual Statement.

Issue 1

The Company listed for two of its bonds held at December 31, 2005 an NAIC designation of "6*." The securities were not filed with the NAIC Securities Valuation Office. The two bonds were Cusip No. 050226-AH-2 and Cusip No. 876306-CE-9. Alabama Insurance Department Regulation No. 98 Section 2 states

A. All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO. B. Other invested assets, not otherwise valued by statute, shall be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (EX4) Subcommittee. C. Any security not valued in accordance with this section shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with subsection A or B of this subsection.

The Company did not perform the filing as required by Regulation No. 98. The Company reported admitted assets of \$280,000 in its 2005 Annual Statement in connection with the two bond holdings. The bonds were not admitted in the financial statements included in this report.

Issue 2

The Company amortized its bond premiums and discounts utilizing the straight line method. SSAP No. 26, paragraph 6 states

Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).

Also, The Company was not amortizing one of its bonds, CUSIP # 581174-AB-5, for the correct term until maturity.

Note 2 – Real estate: Properties held for the production of income

\$ 79,263

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

SSAP No. 40, paragraph 12 indicates "For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date..." The Company did not maintain the required appraisals.

Due to the asset being immaterial, no changes were made for this account in the financial statements included in this report. It was noted that the asset was disposed of during 2006.

Note 3 - Cash

\$10,358,295

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

Issue 1

The Company's short-term investment held in its AmSouth Bank account at year end 2005 was reported as cash. The balance should have been reported in the short-term investments parenthetical of line 5 of the Annual Statement and Schedule DA for short-term investments in accordance with the NAIC Annual Statement Instructions. The instructions indicate, for reporting in Schedule DA, "The categories of assets to be reported are: ... other short-term investments..." The instructions indicate that the items to be included in Schedule E are cash and cash equivalents only.

Issue 2

The Company's bank signature cards identifying the signors authorized to conduct banking activities included a former employee who has retired.

Note 4 - Losses

\$ 714,900

Loss adjustment expenses

\$ 107,235

The above captioned amounts are the same as reported by the Company in its 2005 Annual Statement.

Issue 1

A random sample of forty-five claim payments was selected from the claims paid during the first half of 2006. A review was performed of each claim file in the sample to determine the dates in which the claims were reported to the Company. For the claims that were reported prior to year end 2005, the examiner checked the year ending 2005 loss reserves listing to make certain that the claim was included in the listing and the reserve held was adequate. The adequacy of the loss reserves at year end 2005 was verified by comparing the reserve held to the ultimate cost to settle the claims. The claim file for one of the claim payments included in the sample indicated that the claim was reported to the Company on December 1, 2005, and the claim was paid on January 4, 2006, but the claim was excluded from the year end 2005 listing of loss reserves. Company management was questioned about the omission. The explanation given was that the Company established a reserve for the claim in December of 2005. At the date of payment, January 4, 2006, the Company had not

produced its list of outstanding reserves. When the listing of reserves was generated from the computer system, the claim was erroneously omitted because the computer record reflected that the claim had been paid and the reserve had been reduced to zero. An omission of a loss reserve results in an understatement of loss adjustment expense reserve as well because the Company's methodology involves holding a reserve for loss adjustment expenses of 15% of the outstanding loss reserves. SSAP No. 55, paragraph 5 states, in part,

The following types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses: a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not by, the reporting entity as of the statement date ... c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses..."

The examination indicated that the extent of the understatement of loss reserves and loss adjustment expense reserves was not material. Due to immateriality, no changes were made in the financial statements included in this report for this issue.

Issue 2

The Company included its paid loss adjustment expenses from its paid losses data run within column 4 of the Schedule P Part 1 Summary. Column 4 is for loss payments. The direct loss adjustment expense payments are to be included in column 6 and column 8 of Schedule P. Because the loss adjustment expenses misallocated were associated with specific claims, most or all of the loss adjustment expenses misallocated should be allocated as defense and cost containment payments which are reported in Column 6 of Schedule P Part 1 Summary.

Issue 3

The Company did not report its salvage and subrogation received in column 10 of Schedule P. Column 10 is for reporting of salvage and subrogation received allocated by the years in which the corresponding losses were incurred.

Issue 4

The Statement of Actuarial Opinion and the actuarial reserve study supporting the opinion did not address the unusual nature of loss and LAE reserves. Loss and LAE reserves exclude IBNR, and are therefore not in compliance with SSAP 55 of the NAIC Accounting Practices and Procedures Manual. However, loss and LAE reserves were in compliance with a permitted practice issued by the Alabama Department of Insurance. The actuary also did not address unearned premium reserves on long-duration contracts. Finally, the actuary did not comment on the permitted practice issued by the Alabama Department of Insurance, and the relationship of that permitted practice to loss and LAE reserves, and to unearned premium reserves.

Although the Company does not write long-duration contracts, the permitted practice allows the Company to earn premiums in a manner consistent with long-duration contracts. The appointed actuary is required to include unearned premiums for long-duration contracts in the reserve opinion.

Note 5 - Unearned premiums

\$6,281,601

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

Issue 1

The Company utilized the monthly pro rata method to calculate its unearned premiums. The Company did not use the correct monthly pro rata factors for one year policies with effective dates in January, 2005, February, 2005, and March, 2005. SSAP No. 53, paragraph 7b states "Monthly pro rata method - This method assumes that, on average, the same amount of business is written each day of any given month so that the mean will be the middle of the month. For example, one-year premiums written during the first three months of the year have, at the end of the year, the following unearned fractions: January - 1/24; February - 3/24; March 5/24."

The error resulted in an understatement of the unearned premiums of \$12,671. The understatement was not material and no changes were made in the financial statements included in this report for the immaterial understatement.

Issue 2

The Company's disclosure of its permitted practices received from the Alabama Department of insurance in its 2005 Notes to Financial Statements was not complete. The disclosure did not include a disclosure of the permitted practice obtained January 17, 2002, from the Department allowing the Company to earn one half of its premiums over a one month term and earn the remaining half of the premiums over a six month term for a specific insurance program. The NAIC Annual Statement Instructions state that the disclosure is to include, in Note 1 Summary of Significant Accounting Policies, "A description of the accounting practice and a statement that the accounting practice differs from NAIC statutory accounting practices and procedures."

Note 6 - Amounts withheld or retained by the company
for the account of others
Collateral deposits

\$ 0

\$ 103,159

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The examination of the write-in liability account "Collateral deposits" reported by the Company in its 2005 Annual Statement indicated that the account was comprised primarily of policyholders' deposits. The examiner determined that the deposit balances should be reported within the line item "Amounts withheld or retained by Company for account of

others" consistent with the NAIC Annual Statement Instructions, which indicate for items to include in the account, "Include: Employee's FICA and unemployment contributions and other withholdings as well as amounts held in escrow for payments of taxes, insurance, etc., under F.H.A. or other mortgage loans; and any other funds that the company holds in a fiduciary capacity for the account of others (excluding reinsurance funds held)."

The misclassification has no effect upon the Company's surplus. No changes were made to the financial statements included in the report for this account.

Note 7 - Payable to parent, subsidiaries and affiliates

\$ 728,175

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The Company did not disclose the amount of commissions and management and service fees paid to each of the affiliates under management and service and agency agreements in Note 10 of the 2005 Annual Statement. The NAIC Annual Statement Instructions state, "The financial statements shall include disclosures of all material related party transactions. In some cases aggregation of similar transactions may be appropriate... The disclosures shall include: ... The dollar amounts of transactions for each of the accounting periods for which the financial statements are presented..."

Note 8 - Premiums Earned

\$8,770,197

The above captioned amount is the same as reported by the Company in its 2005 Annual Statement.

The Marketplace Insurance assumed reinsurance agreement was not signed within nine months of the inception date. The agreements inception date was March 1, 2005. The agreement was signed by a Company officer February 21, 2005. The agreement was not signed by a Marketplace Insurance officer until March 16, 2007. SSAP No. 62, paragraph 23 states, in part, "if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement."

In 2005, the Company received assumed premium of \$135,000 and paid no losses and held no loss reserves at year end 2005 in connection with the assumed reinsurance agreement. The transactions were immaterial and no changes were made to the financial statements included in this report.

Note 9 - Unassigned funds

\$41,554,997

The above captioned amount is \$280,000 less than the \$41,834,997 reported by the Company in its 2005 Annual Statement. The following is a reconciliation of Unassigned funds per the examination:

Unassigned funds per Company		\$41,834,997
Examination increase/(decrease) to assets:		
Bonds	\$(280,000)	
Change in Unassigned funds		<u>(280,000)</u>
Total Unassigned funds per the examination		<u>\$41,554,997</u>

COMMENTS AND RECOMMENDATIONS

Management and Control – Page 14

It is **recommended** that the Company hold its annual stockholder meetings on the first Thursday in March in accordance with the Company's By-Laws.

Corporate Records – Page 6

It is **recommended** that the Company implement procedures to ensure that the Company complies with Section 1033 of Title 18 of the United States Code, which prohibits employees, producers, insurance agencies, consultants, third party administrators, or MGA's of the Company or subcontractors of the Company or of an agency of the Company who have been convicted of a felony involving dishonesty or a breach of trust unless the prohibited person has obtained permission to serve in the capacity by the Commissioner.

Policy Forms and Underwriting – Page 10

It is **recommended** that the Company retain its policy application files and maintain accurate documentation of the application files so that it is apparent what action was taken in accordance with ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is **recommended** that the Company maintain complete records of its policy files as required by ALA. CODE §27-27-29(a)(1975) states, in part, "Every domestic insurer...shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Claims Review – Page 12

It is **recommended** that the Company maintain complete records of its claim files in accordance with ALA. CODE §27-27-29(a) (1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company maintain claim files that are accessible and retrievable for examination in accordance with ALA. ADMIN. CODE 482-1-125.04, which states, "The insurer shall maintain claim files that are accessible and retrievable for examination."

Accounts and Records – Page 14

It is recommended that the Company review IRS Revenue Procedure 1998-25 and develop guidance which ensures continual compliance.

It is recommended that the Company develop and periodically test a business contingency plan.

It is recommended that the Company specify in a written agreement with Red Mountain Technologies, Inc. the specifics of its agreement whereby Red Mountain Technologies, Inc. performs certain information systems services for the Company. An effective agreement will ensure that Red Mountain Technologies, Inc. retains the required information ensuring that the Company complies with ALA. CODE §27-27-29(a)(1975), which requires the Company to maintain "... complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary and suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company require its independent auditor to perform test work of the Company's consulting and opining actuary's assumptions, methods, and findings.

It is recommended that the Company present its deferred tax account in one single account in its financial statements in accordance with SSAP No. 10, paragraph 7 which states, in part, "DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position."

Bonds – Page 21

It is recommended that the Company perform the required filings of its securities with the NAIC Securities Valuation Office. Otherwise, the securities are to be reported as not admitted in the Company's financial statements consistent with Regulation No. 98 Section 2, which states,

A. All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO. B. Other invested assets, not otherwise valued by statute, shall be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (EX4) Subcommittee. C. Any security not valued in accordance with this section shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with subsection A or B of this subsection.

It is recommended that the Company amortize its bond premiums and discounts utilizing the scientific method in accordance with SSAP No. 26, paragraph 6, which states

Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).

It is recommended that the Company amortize its bond, CUSIP # 581174-AB-5, for the correct term until maturity.

Real Estate - Page 21

It is recommended that the Company maintain the required appraisals of its real estate classified as held for the production of income as required by SSAP No. 40, paragraph 12, which states, "For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date..."

Cash - Page 22

It is recommended that the Company properly report its short-term investments in the Annual Statement parenthetical and in Schedule DA in accordance with the NAIC Annual Statement Instructions which indicate, for reporting in Schedule DA, "The categories of assets to be reported are: ... other short-term investments..."

It is recommended that the Company update its bank signature cards that identify the signors authorized to conduct bank account activities to remove former employees who have retired.

Losses - Page 22

It is recommended that the Company record liabilities for losses and loss adjustment expenses associated with all reported claims consistent with SSAP No. 55, paragraph 5 which states, in part,

The following types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses: a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not by, the reporting entity as of the statement date ... c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses...

It is recommended that the Company report its paid loss adjustment expenses allocated by accident year within Schedule P Part 1 Summary columns 6 and 8 in accordance with the NAIC Annual Statement Instructions.

It is recommended that the Company properly report its salvage and subrogation received in Schedule P.

It is recommended that the Company require its appointed actuary to provide background relating to the permitted practice regarding unearned premium reserves and loss and LAE reserves. Future reserve opinions and reserve studies should clearly state that loss and LAE reserves do not include IBNR, and the reasons for reporting the liability in that way. It is further recommended that the Company require the appointed actuary to address unearned premium reserves on long-duration contracts, since that liability is established in the place of IBNR reserves, and the Company treats the policies as long-duration for purposes of calculating unearned premium reserves.

Unearned Premiums – Page 24

It is recommended that the Company correct its unearned premium calculation to utilize the correct monthly pro rata factors consistent with SSAP No. 53, paragraph 7b which states, “Monthly pro rata method - This method assumes that, on average, the same amount of business is written each day of any given month so that the mean will be the middle of the month. For example, one-year premiums written during the first three months of the year have, at the end of the year, the following unearned fractions: January - 1/24; February - 3/24; March 5/24.”

It is recommended that the Company completely and accurately disclose all accounting practices that differ from statutory accounting principles in Note 1 of the Notes to Financial Statements in accordance with the NAIC Annual Statement Instructions, which state that the disclosure is to include in Note 1, Summary of Significant Accounting Policies, “A description of the accounting practice and a statement that the accounting practice differs from NAIC statutory accounting practices and procedures.”

Amounts Withheld or Retained by Company for Account of Others – Page 24

It is recommended that the Company report its collateral deposits within the Annual Statement line item “Amounts withheld or retained by the company for account of others” consistent with the NAIC Annual Statement Instructions, which indicate for the line item, “Include: Employee’s FICA and unemployment contributions and other withholdings as well as amounts held in escrow for payments of taxes, insurance, etc., under F.H.A. or other mortgage loans; and any other funds that the company holds in a fiduciary capacity for the account of others (excluding reinsurance funds held).”

Payable to Parent, Subsidiaries and Affiliates – Page 25

It is recommended that the Company disclose the amount of commissions and management and service fees paid to each of the Company’s affiliates in accordance with the NAIC Annual Statement Instructions, which state “The financial statements shall include disclosures of all material related party transactions. In some cases aggregation of similar transactions may be appropriate... The disclosures shall include: ... The dollar amounts of

transactions for each of the accounting periods for which the financial statements are presented...”

Premiums Earned – Page 25

It is recommended that the Company account for all reinsurance agreements that are not signed by both parties within nine months of the inception date of the reinsurance as retroactive reinsurance in accordance with SSAP No. 62, paragraph 23, which states, in part, “if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement.”

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of commitments and contingent liabilities included an inspection of representations made by management, consideration of the CPAs work performed with respect to testing unreported contingent liabilities, and a review of the Company’s transactions subsequent to the examination date. The review did not indicate any contingent liabilities as of December 31, 2005. Company management represented that no material non-policy related litigation was open against the company as of April 6, 2007. Company management did not subsequently disclose any material pending litigation in the letter of representation provided to the examiners bearing the same date as this report.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

It was recommended in the most recent Report of Examination that the Company obtain an appraisal to support the fair market valuation of its real estate. The Company did not comply with the recommendation. The Company did have an appraisal of its home office property, but did not maintain an appraisal that was less than five years old, as of the reporting date, of its properties held for the production of income. The appraisal is required to be maintained by SSAP No. 40, paragraph 12. Further discussion of the failure to comply with SSAP No. 40 is included in this report under the caption “NOTES TO FINANCIAL STATEMENTS.” It was noted that the properties that were held for the production of income has subsequently been disposed of.

It was recommended in the prior Report of Examination that the Company’s stockholder comply with the Company’s By-Laws by conducting its annual stockholder’s meeting on the first Thursday in March each year. The Company did not hold its annual stockholder’s meeting on the first Thursday in March each year as required to do so by the Company’s By-Laws. The 2001 stockholder meeting was held on Thursday, December 20, 2001. The 2003 meeting was held on Friday, March 7, 2003.

SUBSEQUENT EVENTS

The examiner reviewed the general ledger and cash transactions subsequent to December 31, 2005. The examiners inquired of management of significant events subsequent to the examination date. There were no material significant events disclosed or discovered.

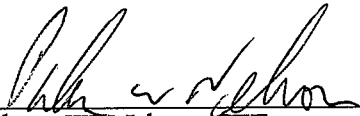
CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by persons representing Centennial Casualty Company during this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Mora Perkins, Examiner; and Glenn Taylor, FCAS, MAAA, and Randall Ross, FCAS, MAAA, of Taylor-Walker & Associates, Consulting Actuaries; all representing the Alabama Department of Insurance, participated in this examination of Centennial Casualty Company.

Respectfully submitted,



Palmer W. Nelson, CFE
Examiner-in-charge
Alabama Department of Insurance